Aalto University
School of Business

Disclosure of Non-Financial Information

Amendments to Reporting under the EU Taxonomy Regulation

Bachelor's Thesis
Touko Hakahuhta
Aalto University School of Business
Accounting
Summer 2020

Aalto University
School of Business

Aalto University, P.O. BOX 11000, 00076 AALTO
www.aalto.fi

Abstract of bachelor's thesis

Author Touko Hakahuhta

Title of thesis Disclosure of Non-Financial Information – Amendments to Reporting under the EU Taxonomy Regulation

Degree Bachelor of Science in Economics and Business Administration

Degree programme Accounting

Thesis advisor(s) Tapani Kykkänen

Year of approval 2020 **Number of pages** 29+7 **Language** English

Abstract

The European Commission has actively introduced new legislative initiatives to facilitate the transition to more sustainable economy and contribute to the United Nations Sustainable Development Goals (SDGs) and the objectives of the Paris Agreement. Recently, one of the main policy areas has been sustainable finance which the European Union has promoted in order to reorient capital flows towards sustainable investment. With this regard, the cornerstone has been so-called Taxonomy Regulation (Regulation (EU) 2020/852) introducing a unified classification system which identifies environmentally sustainable economic activities. Due to the new regulations it is likely that non-financial information will increase in importance and benefit investors, stakeholders and society.

The transparency and quality of non-financial information can be seen as prerequisites for sustainable finance. Therefore, the focus of this research is on non-financial disclosure from the perspective of sustainability. First, this research examines the current non-financial disclosure obligations and the new requirements imposed by the Taxonomy Regulation. Second, this research evaluates whether the content of the disclosure is sufficient in terms of sustainability.

This research studies mandatory non-financial disclosure obligations of large, public-interest entities (PIEs). Currently, these entities must disclose non-financial information in relation to environment, social and employee matters, human rights as well as anti-corruption and bribery under the EU's Non-Financial Reporting Directive (Directive 2014/95/EU) and the Finnish Accounting Act (1336/1997). However, the Taxonomy Regulation entered into force in July 2020 includes a new disclosure obligation on how and to what extent the economic activities qualify as sustainable. In order to determine the sustainability, the regulation requires substantial contribution to one or more environmental objectives and defines the Do No Significant Harm principle as well as the minimum safeguards.

The findings suggest that the Taxonomy Regulation is a step further in sustainability. However, the Non-Financial Reporting Directive is currently under the European Commission's review and there is a need to align its provisions with the Taxonomy Regulation. In addition, the social dimensions of sustainability should be taken into account in the future as well as simplified standards for small and middle-sized enterprises considered. In conclusion, the findings indicate that the taxonomy has potential to scale up sustainable finance and promote sustainable economic activities.

Keywords Non-financial disclosure, sustainability, sustainable finance, taxonomy, classification system, the Non-Financial Reporting Directive (NFRD), the Accounting Act, the Taxonomy Regulation

Table of Contents

ABBREVATIONS

CSR	Corporate Social Responsibility
DNSH	Do No Significant Harm
EC	The European Commission
ESG	Environmental, social and governance
GRI	Global Reporting Initiative
HE	Hallituksen esitys (Government Proposal)
HLEG	The High-Level Expert Group on Sustainable Finance
IFRS	The International Financial Reporting Standards
KILA	Kirjanpitolautakunta (The Accounting Board)
NFRD	Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, OJ L 330, 15.11.2014, p. 1–9. (The Non-Financial Reporting Directive)
OECD	Organisation for Economic Co-operation and Development
OECD Guidelines	the OECD Guidelines for Multinational Enterprises
Paris Agreement	The Paris Agreement under the United Nations Framework Convention on Climate Change, 12.12.2015
PIE	Public-interest entity

SDGs	The Sustainable Development Goals
SMEs	Small and middle-sized entities
TEG	The Technical Expert Group on Sustainable Finance
TR	Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, OJ L 198, 22.6.2020, p. 13–43. (The Taxonomy Regulation)
UN	The United Nations
UNGPs	The UN Guiding Principles on Business and Human Rights

1 INTRODUCTION

1.1 Setting the Scene

The European Commission declared in 2019 that the EU will be a global leader in sustainability.[1] At the heart of this so-called European Green Deal are the United Nation's Sustainable Development Goals (SDGs) to which all the EU actions and policies must contribute.[2] These noble ambitions include, inter alia, that there are no net emissions of greenhouse gases by 2050 and economic growth is decoupled from resource use.[3] The European Commission has also announced in the aftermath of the COVID-19 pandemic that the economic recovery should respect the same objectives.[4]

To enable the transition to sustainable economy, the European Commission recognized that there is a great need to engage private investments and funds to achieve the objectives set in the European Green Deal.[5] To facilitate private financial and capital flow towards green investment, the European Commission couples the establishment of a classification system for environmentally sustainable activities and measures improving the disclosure of environmental and climate information.[6] In other words, the European Commission will increase the amount of non-financial data available and improve its quality in order to engage sustainable private investments.

Although sustainability has recently been included in all policy areas of the EU, the classification system and transparency considerations actually pre-date the European Green Deal.[7] The both initiatives are covered under sustainable finance. It has been acknowledged in literature that the scaling up sustainable finance requires transparency and information.[8] First and foremost, sufficient information, whether or not a particular investment meets the expectations in terms of sustainability, is vital for investors.[9] This represents the traditional shareholder-centric perspective, which has been embraced in Finland. However, the same applies to other stakeholders as well, and has high importance when it comes to the

[1] COM(2019) 640 final, p. 1-2 and 20-22.
[2] Ibid, p. 3. See also United Nations 2015.
[3] Ibid, p. 2.
[4] COM(2020) 456 final, p. 6.
[5] COM(2019) 640 final, p. 16-17. See also the Paris Agreement, article 2.
[6] Ibid, p. 17.
[7] The sustainable finance objectives were addressed already in March 2018 in the Sustainable Finance Action Plan. See COM(2018) 97 final.
[8] See Cullen & Mähönen 2019, p. 105.
[9] Cullen & al 2020, p. 73.

legitimacy of an entity. Therefore, it is likely that non-financial reporting will increase in importance due to the new regulations and benefit investors, stakeholders and society as well as reporting entities in terms of sustainable development.

1.2 Research Problem, Research Questions and Objectives

The focus of this research is on non-financial disclosure from the perspective of sustainability. The current non-financial disclosure requirements can be considered insufficient because reporting lacks quality and comparability to assess the impacts and risks of companies.[10] The European Commission has drawn similar conclusions as well and introduced new regulatory initiatives. Namely, recently adopted Taxonomy Regulation aims at tackling these challenges. Also, the non-financial disclosure obligations will be under the review during the 2020 in order to align the reporting obligations with the Taxonomy Regulation and foster transparency.

As per the research problem defined above, the research questions will be twofold:

1. What are the current non-financial disclosure obligations and what new requirements does the Taxonomy Regulation impose?
2. Whether the content of the disclosure is sufficient in terms of sustainability?

The objective of this research is to form an overall picture of the non-financial disclosure obligations as well as of the content of non-financial information. At the same time, the research aims at examining the importance of the non-financial information besides the financial information. In addition, this research is among the first contributions to evaluate the Taxonomy Regulation from the perspective of the disclosure of non-financial information.

1.3 Methodology and Sources

This research is a literature review in nature. In order to answer the first research question, a legal dogmatic methodology will be applied. The legal dogmatic method concentrates on valid and binding law with an emphasis on interpretation and systematisation of law.[11] In this research, the non-financial disclosure obligations and the key features of the Taxonomy Regulation will be determined through the method.

[10] The Alliance for Corporate Transparency 2020, p. 10.
[11] Hirvonen 2011, p. 22.

With regard to the first research question, the hierarchy of legal sources has a specific importance. In Finland, Aarnio has presented the most cited theory by dividing legal sources into three groups according to their binding effect. Strongly binding sources are the norms of statutory law and established custom. Weakly binding sources are the norms provided by legislative drafts and the precedents of the highest court instances. Permitted sources are inter alia jurisprudence and legal principles.[12] The starting point for this research is the statutory law defining disclosure obligations on non-financial information both on the EU and national level. Furthermore, official sources such as the preliminary documents of the statutes are extremely important in order to interpret statutes and systematise the law as its stands. In addition, previous research and academic literature will be taken into account. Empirical data from the industrial sector will be examined as well in order to give practical evidence.

As for the second research question, the content of disclosed information will be analysed based on academic literature. However, it can be assumed that the amount of academic literature is limited due to the novelty of the Taxonomy Regulation. Therefore, other sources may be referred to in order to support the findings. Through literature review, an evaluation of the classification system will be established and the non-financial disclosure analysed.

1.4 Definitions

1.4.1 Sustainability and Sustainable Finance

According to *Chang & al*, there are approximately three hundred definitions of sustainability. The authors describe that all the definitions emphasise the balanced existence of the ecosystem and the human social and economic system. Furthermore, economic, environmental and social dimensions are widely recognized.[13] When it comes to sustainable finance, the main focus is systematically on promoting the sustainable economic development.[14] From narrower, market actors' perspective, the common denominator is the integration of environmental, social and governance (ESG) factors in financing.[15] Emphasis is above all on environmental considerations but also social aspects are becoming increasingly important. Additionally, it is often considered characteristic that the sustainable finance is associated

[12]See Aarnio 1989, p. 220-247.
[13] Chang & al 2017, p. 49.
[14] Tîrcă & al 2019, p. 11.
[15] E.g. HLEG Final Report 2018, p. 10., ICMA 2020, p. 3-4., European Commission 2017, p. 4.

with the longer term benefits compared with the dominant short-termism on the financial market.[16]

Besides the sustainability, the term corporate social responsibility (CSR) often appears in the same contexts. For instance, the European Commission has described CSR as a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.[17] However, The EC has redefined the term more broadly in 2011 and viewed CSR as the responsibility of enterprises for their impacts on society.[18] Therefore, CSR will be viewed as a synonym for sustainability.[19] In this research, sustainable finance as well as sustainability covers all three ESG factors and entails the longer than short-term perspective to these dimensions.

In principle, the sustainable finance can refer to any form of financial service such as loans, bonds, stocks and funds to name a few.[20] Within the EU's recent sustainable finance initiatives, two characteristics have been acknowledged: 1) the contribution of finance to sustainable and inclusive growth as well as the mitigation of adverse environmental impacts and 2) the strengthening of financial stability by incorporating ESG factors into investment decision-making.[21] This research approaches sustainable finance from the regulatory perspective instead of analysing the design of different instruments.

1.4.2 Non-Financial Disclosure

In this research, the terms non-financial information and non-financial disclosure refer to information on sustainability. However, the emphasis is on environmental considerations due to the main objectives of the recent regulatory initiatives. With regard to the disclosure of non-financial information, only the periodic disclosure in connection with the publication of the annual financial statements and the management report is under scrutiny.

This research will be limited to large, public-interest entities (PIEs), which have the mandatory disclosure obligation on non-financial information. In contrast, small and middle-sized

---

[16] HLEG Final Report 2018, p. 9-10., Mähönen 2019, p. 100. Tîrcă & al 2019, p. 11.
[17] COM(2001) 366 final, p. 6.
[18] COM(2011) 681 final, p. 6.
[19] See e.g. Testarmata & al 2020.
[20] E.g. ICMA 2018, p. 30.
[21] HLEG Final Report 2018, p. 6.

entities (SMEs) are not discussed in the absence of mandatory obligation. In addition, the specific requirements of some financial companies in relation to the Regulation on Sustainability-Related Disclosures in the Financial Services Sector are not analysed.[22]

1.4.3 EU Taxonomy

The Taxonomy Regulation (TR) introduces a unified classification system which identifies environmentally sustainable activities. The system will be called either the taxonomy or the classification system in this research. The classification system will be at the heart of the upcoming sustainable finance initiatives within the EU and functions as a tool in the transition to more sustainable economy. In this research, the key features of the taxonomy will be analysed.

1.5 Structure

This research consists of four chapters. Introduction to the research questions is presented above in the first chapter. Next, in Chapter two, I am going to discuss the theory behind the disclosure obligations and analyse the current legislation from the non-financial point of view. In Chapter three, I am going to give an overview on and evaluate the EU's new Taxonomy Regulation which has recently entered into force. Finally, I will summarize the findings in Chapter four as well as draw conclusions for future research.

2 DISCLOSURE OF NON-FINANCIAL INFORMATION

2.1 Theoretical Approach to Disclosure Obligations – from the Legitimacy Theory to Sustainability Accounting

Before discussing the legal and economic functions of the disclosure obligations, I am going to bring forward a couple of theoretical notions regarding the legitimacy of companies. This is important in order to create a holistic picture of sustainability which is basically accomplished by being able to continue business operations over a long period of time. Hence, sustainable companies adapt to the prevailing values of their communities and interact with their stakeholders to achieve the objective.

[22] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, OJ L 317, 9.12.2019, p. 1–16.

According to *Dowling & Pfeffer's* definition of legitimacy theory, the survival of organisation is connected with the social norms and values which must be respected in order to exist. The authors indicate that the organisations may legitimate their activities by 1) adjusting their values, output or methods of operation to the social norms and values, 2) communicating to alter the social norms and values so that they conform to the present practices, output and values of the organisation, or 3) becoming identified with socially legitimate symbols, values or institutions.[23] Noteworthy, in the context of this research, all these strategies require disclosure if they are to be successful.[24]

Sustainability accounting, or social and environmental accounting research, surveys the social and environmental impacts of a company, and concentrates on accounting and disclosing the impacts to stakeholders. Sustainability accounting often refers to the legitimacy theory by reflecting that organisations seek to obtain or maintain its legitimation via an interactive social contract – sort of society's permission to operate.[25] This can be seen as a theoretical explanation for the voluntary disclosure of the non-financial information. From this perspective, organisations aim at communicating that their operations are environmentally, socially and economically in line with the norms and values of society by non-financial reporting.[26] However, there is evidence that organisations seems to have a tendency to manipulate the reporting, e.g. by changing the information coverage or unbalancing reporting in the positive direction, in order to maintain the legitimacy.[27] This indicates that the voluntary non-financial disclosure does not promote sustainability efficiently at the end of the day.

2.2 Functional Approach to Disclosure Obligations – Law and Economics

As for the functions of the mandatory disclosure system, *Coffee* distinguishes three historical phases. At the first stage, the objective of the system was to protect investors. At the second stage, so-called revisionists criticised the system for not creating clear benefits but considerable costs. At the third and final stage, the system was based on the Efficient Capital Market Hypothesis.[28] In a nutshell, the hypothesis states that the financial markets incorporate all the possible information in setting the prices and as a consequence, there should be no

[23] Dowling & Pfeffer 1975, p. 125-127.
[24] Deegan 2014, p. 258.
[25] Beske & al 2019, p. 167.
[26] Ibid.
[27] Ibid, p. 168-169.
[28] Coffee 1984, p. 717-720.

opportunities available for investors to profit from under- or overvaluation.[29] Coffee finds that efficiency-based arguments, such as the reduced price dispersion of securities, are the strongest in favour of the mandatory disclosure system.[30]

Although Coffee analyses the functions of the disclosure system from a historical perspective, the same elements are distinguishable still today. The purpose of the disclosure obligations is to ensure that all investors have equal access to information.[31] This facilitates effective price setting, reduces information asymmetries and protects investors in order to create a framework for efficient capital markets. From the non-financial point of view, the information asymmetry between the company's management and both investors and other stakeholders can be seen as a great challenge to be faced by the non-financial reporting.[32] In other words, the objective of the non-financial disclosure should be to manage and reduce this information asymmetry. Traditionally, legislators have addressed the problem by requiring disclosure and transparency in order to provide the necessary and assured information for investors.[33]

Financial reporting has long been vital for the investors. For example, the International Financial Reporting Standards (IFRS) are well-established among the listed companies. Especially earlier, the non-financial information was disregarded from corporate reporting by distinguishing financial and non-financial reporting from each other.[34] The main difference, and a potential problem, between the financial and non-financial reporting is that the former is quantitative by its nature. Therefore, qualitative non-financial reporting seems to be only a side issue due to lack of a common framework. However, it is clear that also the environmental concerns may impose a financial risk for business. Therefore, more attention should be paid to the non-financial information in order to analyse businesses as a whole.

When it comes to non-financial disclosure obligations, it has been widely debated whether reporting should be voluntary or mandatory. *Armour & al* note that, in theory, there should be strong incentives for issuers to disclose information voluntarily in order to distinguish

---

[29] Armour & al 2016, Part B Financial Markets – 5 Theory of Financial Markets – 5.2. Efficient Markets – 5.2.1 The concept of 'informational efficiency'.
[30] Coffee 1984, p. 751-752.
[31] Parkkonen & Knuts 2014, p. 144.
[32] Testarmata & al 2020, p. 68.
[33] Cullen & Mähönen 2019, p. 100.
[34] Clarke & Anker-Sørensen 2019, p. 198.

themselves from lower performing ones.[35] However, it is problematic that the voluntary disclosure seems to lead to a lower level of transparency, quality and comparability of information.[36] Traditionally, companies have been in favour of voluntary reporting while non-governmental organisations have supported mandatory obligations but the both parties seem to have recently supported mandatory disclosure unanimously.[37] For instance *Mähönen* finds that the legislators must choose to either impose mandatory regulations or encourage self-regulation.[38] The EU has adopted the former by harmonization through directives which will be further analysed in the next chapter.

When assessing the sustainability of companies, it has to be noted that disclosure is a weak, ex post mechanism for the assessment but it may have a positive effect on implementing sustainability considerations into the corporate governance over the long term.[39] In addition, the disclosed non-financial information may improve sustainability by steering the management and stakeholders.[40] In this research, I will pay attention especially to the information required by the Taxonomy Regulation in the Chapters 3.3 and 3.4.

2.3 Background – From Voluntary to Mandatory Disclosure

The EU introduced non-financial reporting first in 2003 in relation to the contents of the annual report. The fourth, later repealed, Accounting Directive required the companies to report, when appropriate, on key performance indicators (KPIs) in relation to environmental matters to the extent necessary for an understanding of the company's development, performance or position (Article 46 of Directive 2003/51/EC). *Wagner* describes that the article cannot be viewed as an obligation to report on non-financial issues due to its conditional language.[41] This was the only provision in relation to non-financial reporting until 2014 when the current disclosure provisions were adopted.

[35] Armour & al 2016, Part B Financial Markets – 8 Issuer Disclosure Regulation – 8.3 Why is Mandatory Disclosure Mandatory?.
[36] Testarmata & al 2020, p. 68.
[37] European Commission 29.7.2020, p. 3. See also Testarmata & al 2020, p. 70.
[38] Mähönen 2013, p. 567.
[39] Clarke & Anker-Sørensen 2019, p. 198. However, differing from the financial statements, the management report and the non-financial statement can be seen as future-oriented. KILA 12.9.2006, p. 8. See also Leppiniemi & Kykkänen 2019, p. 156.
[40] Mähönen 2013, p. 573.
[41] Wagner 2018, p. 660.

In 2013, the non-financial disclosure obligations were moved to article 19(1) of the new Accounting Directive (Directive 2013/34/EU) which repealed the fourth Accounting Directive. During the preliminary work, no need to revise the obligations was detected.[42] With respect to the terminology, management report replaced the annual report in order to align the text with the modern accounting language.[43] However, when the new Accounting Directive entered into force, the European Commission had already started to draft amendments regarding the non-financial information.

The starting signal for the current non-financial disclosure obligations can be traced back to April 2011 when the transparency of the social and environmental information was mentioned in connection with socially fairer and environmentally sustainable growth.[44] The EC presented a more detailed statement on the importance of non-financial information in a renewed EU strategy for corporate social responsibility in October 2011. At that time, the EC had adopted a stakeholder-friendly approach by enhancing the accountability and building public trust in companies.[45] The key objectives were on the one hand to increase the transparency of social and environmental information and on the other hand, to ensure a level playing field within the companies in all sectors.[46] The European Parliament strongly supported the EC to draft a proposal on non-financial disclosure in its resolutions in 2013 emphasising the transparency and comparability of information in order to monitor companies' impact on society.[47]

During the preliminary work, the EC estimated that approximately 2.500 European companies of the 42.000 companies operating in Europe published CSR or sustainability reports.[48] At the same time, 161 companies of 608 respondents reported on CSR issues in Finland according to the PricewaterhouseCoopers Oy.[49] The both numbers cover mandatory reporting on environmental and employee matters in management reports as well as voluntary reporting.

[42] COM(2011) 684 final, p. 11.
[43] Ibid, p. 9.
[44] COM(2011) 206 final, p. 14-15.
[45] COM(2011) 681 final, p. 6 and 11.
[46] COM(2013) 207 final, p. 2. COM(2011) 681 final, p. 12. COM(2011) 206 final, p. 15.
[47] European Parliament resolution of 6 February 2013 on Corporate Social Responsibility: promoting society's interests and a route to sustainable and inclusive recovery, OJ C 24, 22.1.2016, p. 33–48, p. 14. European Parliament resolution of 6 February 2013 on corporate social responsibility: accountable, transparent and responsible business behaviour and sustainable growth, OJ C 24, 22.1.2016, p. 28–33, p. 4.
[48] COM(2011) 681 final, p. 11.
[49] HE 208/2016 vp, p. 4.

The debate between voluntary and mandatory non-financial disclosure came to an end in 2014, when the EU introduced mandatory non-financial statements for large, public-interest entities through the Non-Financial Reporting Directive (Directive 2014/95/EU, NFRD). Hence, the underlying reason for transition was a need for more transparent information with regard to both quantity and quality.[50] The EC estimated that the new requirement would cover around 18.000 companies in the EU of which approximately 100 are registered in Finland.[51]

The objective of the directive was to increase the relevance, consistency and comparability of non-financial information.[52] It can be noted that the European Parliament had already earlier underlined the importance of disclosure of social and environmental information in order to promote corporate social responsibility (CSR).[53] In the legislative procedure, the legislative bodies unanimously held that disclosure of non-financial information is vital e.g. for managing change towards a sustainable global economy by combining long-term profitability with social justice and environmental protection.[54]

2.4 Current Legislation

2.4.1 Non-Financial Reporting Directive

The Non-Financial Reporting Directive lays out the minimum requirements for non-financial disclosure within the EU. Pursuant to Article 19a(1), information in relation to environment, social and employee matters, human rights as well as anti-corruption and bribery must be disclosed.[55] The non-financial statement shall include within these areas as a minimum 1) a description of the company's business model, 2) a description of its policies, 3) the outcome of the policies, 4) risk-related aspects and 5) the relevant non-financial KPIs. The NFRD follows the "comply or explain" principle: if the company does not comply with the disclosure obligations, it has to give a clear and reasoned explanation for doing so. This provides companies an opportunity to flexibly decide case-by-case the policies to follow. On the other hand, it may be criticised that the "comply and explain" principle would increase the amount of sufficient information.

---

[50] SWD(2013) 127 final, p.10.
[51] COM(2013) 207 final, p. 7. HE 208/2016 vp, p. 7.
[52] NFRD, recital 21.
[53] European Parliament 2013, p. 39 and 46.
[54] NFRD, recital 3.
[55] The same requirements apply to the parent entities of large groups which are obligated to disclose a consolidated non-financial statement (article 29a). In this case, the subsidiaries are exempted from disclosing a non-financial statement (article 19a(3)).

When it comes to the reporting format, the non-financial information is disclosed in the management report by default (article 19a(1)). However, the EU member states may enact provisions allowing companies to publish non-financial information in a separate report (article 19a(4)). More importantly, the NFRD does not define a reporting standard to apply. Instead, the companies are allowed to choose themselves the reporting framework to rely upon (article 19a(1)(5)). The reporting frameworks will be discussed in more detail later in Chapter 2.5.

The Non-Financial Reporting Directive amends the new Accounting Directive[56] and requires certain large companies to disclose non-financial information in their management reports from 2018 onwards. According to Article 19a of the Non-Financial Reporting Directive, the rules apply to large, public-interest entities which have 500 employees on average during the financial year. This constitutes a three-step test: 1) entity is a large company as defined in article 3(4) of the Accounting Directive, 2) an average number of employees exceeds 500 during the financial year and 3) company is a public-interest entity. The term public-interest entity in article 2(1)(1) is new in the Accounting Directive and adopted from the Statutory Audit Directive[57]. Hence, all the listed companies as well as banks and insurance companies, whether listed or not, are public-interest entities.[58]

The NFRD is minimum harmonization by its nature. In other words, the EU member states have a possibility to extend the scope of application but this option is rarely used is general. Furthermore, the directive does not contain detailed rules for the content of reporting. Neither does it impose mandatory EU level standards or a particular framework as a basis for reporting.[59] The objective of the NFRD can be seen to harmonize the sustainability reporting system on the EU level in terms of what information must be communicated and where it must be arranged.[60]

---

[56] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, OJ L 182, 29.6.2013, p. 19–76.
[57] Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC, OJ L 157, 9.6.2006, p. 87–107.
[58] COM(2004) 177 final, p. 4.
[59] Testarmata & al 2020, p. 73.
[60] Carini & al 2018, p. 7.

The European Commission has clarified the non-financial reporting by publishing non-binding guidelines which encompass the methodology in order to promote the quality, relevance and comparability of the reports.[61] In addition, the Accounting Board has given a recommendation on non-financial reporting in Finland which however seems to primarily repeat the obligations of the NFRD.[62] However, many authors have called for more detailed regulation covering for instance reporting frameworks, which are addressed later in this research.[63] The purpose of the guidelines is to promote high quality, relevant, useful, consistent and more comparable non-financial disclosure by describing the obligations of the NFRD in more detail with examples.[64]

2.4.2 Accounting Act

In Finland, the non-financial reporting is regulated under chapter 3a of the Accounting Act (1336/1997) under which the large, public-interest entities must provide a statement of non-financial information as part of the management report. However, the reporting entities may alternatively disclose a separate report according to chapter 3a, section 5. The common practise is still to include a statement of non-financial information in the management report.[65] It is noteworthy that the management report is not included in the financial statements but rather a separate attachment to the financial statements, albeit the documents are published together.[66] From the Finnish perspective it can be noted that the requirement of true and fair view (chapter 3, section 2 of the Accounting Act) does not cover a management report nor a non-financial statement.[67]

[61] European Commission 2017, p. 4.
[62] KILA 1972/7.9.2017.
[63] Testarmata & al 2020, p. 85.
[64] European Commission 2017, p. 4.
[65] According to the government proposal, approximately 40% of the companies published a separate report in 2015. HE 208/2016 vp, p. 7.
[66] According to Chapter 3 Section 1 Subsection 3 of the Accounting Act, a management report must be attached to the financial statements.
[67] HE 208/2016 vp, p. 10.

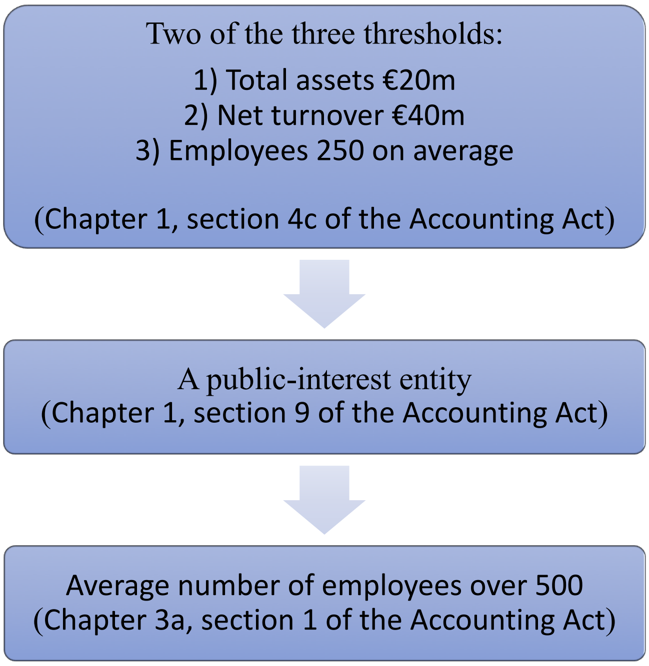

Figure 1. Obligation to provide a non-financial statement.

The scope of application is aligned with the NFRD and is therefore not repeated in this chapter.[68] Also, the contents of the non-financial statement are aligned with the NFRD and similarly to the directive, the Accounting Act does not provide detailed rules for the content of reporting nor reporting framework (chapter 3a, section 2). However, the criteria of large undertaking laid out in chapter 1, section 4c of the Accounting Act must be exceeded in the previous financial year and the one immediately preceding it. The elements of the above-mentioned three-step test are presented from the Finnish perspective above in Figure 1.

When it comes to responsibility and liability for drawing up and publishing the management report and the non-financial statement, the Accounting Directive requires that the members of the administrative, management and supervisory bodies of an undertaking have a collective responsibility (article 33). In Finland, under the Limited Liability Companies Act and the Co-operatives Act the Board of Directors shall be responsible for the appropriate arrangement of the control of the company accounts and finances.[69] Furthermore, the Managing Director shall see to it that the accounts of the company are in compliance with the law and that its financial affairs have been arranged in a reliable manner.[70] If a member of the

[68] See HE 208/2016 vp, p. 6.
[69] See chapter 6, section 2 of the Limited Liability Companies Act (624/2006) and chapter 6, section 2 of the Co-operatives Act (421/2013).
[70] See chapter 6, section 17 of the Limited Liability Companies Act and chapter 6, section 17 of the Co-operatives Act.

board of directors or the managing director deliberately or negligently causes damages to the undertaking, a shareholder or a third party, he or she is liable (chapter 22, section 1 of the Limited Liability Companies Act, chapter 25, section 1 of the Co-operatives Act and chapter 16, section 1 of the Securities Markets Act). However, the threshold for liability is probably high with regard to the non-financial disclosure and the liability therefore fairly unlikely.

2.5 Reporting Frameworks

As mentioned earlier, the NFRD does not include detailed rules for the content of reporting. Neither does it impose a mandatory standard or a reporting framework for non-financial information. This approach was reasoned with flexibility in order to provide an opportunity for companies to choose the most suitable framework for their decision-making and communication purposes.[71] However, it can be noted that this has decreased the level of comparability of the reporting. The directive has tried to prevent the problem by requiring the EC to prepare non-binding guidelines on non-financial reporting (article 2).

At the end of the day, the reporting frameworks applied by companies are at the heart of non-financial reporting. The NFRD refers to several national, EU level and international frameworks.[72] Neither the directive nor the guidelines on non-financial reporting prioritize the frameworks but it is recommended in the guidelines that information is disclosed according to widely accepted standards and frameworks in order to maximise the comparability of the information.[73]

In order to give practical evidence on non-financial reporting practices I have gathered empirical evidence by examining the annual periodic reporting covering the financial year 2019. The evidence is limited to the large cap industrial companies listed in Helsinki Stock Exchange (Nasdaq Helsinki). Evidence is presented in Table 1 below.

[71] COM(2013) 207 final, p. 7.
[72] NFRD, recital 9.
[73] European Commission 2017, p. 8.

Table 1. Sustainability reporting of the large cap industrial companies listed in the Helsinki Stock Exchange.

Company	Non-financial statement in management report	Separate sustainability report	Reporting framework
Cargotec Oyj	Yes	Yes	GRI
Huhtamäki Oyj	Yes	Yes	GRI
KONE Oyj	Yes	Yes	GRI
Konecranes Oyj	Yes	Yes	GRI
Metso Oyj	Yes	Yes	GRI
Outotec Oyj	Yes	Yes	GRI
Valmet Oyj	Yes	Yes	GRI
Wärtsilä Oyj	Yes	Yes	GRI
YIT Oyj	Yes	Yes	GRI

From a practical point of view, it can be summarized that companies often include a narrow non-financial statement in their management report which presents environment, social and employee, human rights as well as anti-corruption and bribery matters in line with the NFRD and the Accounting Act. In addition, at least the listed companies seem to publish a separate, more extensive sustainability or CSR report, which is prepared according to some reporting framework or a standard. Therefore, two objectives of the reporting may be distinguished. The objective of the non-financial statement is to fulfil the legal obligation to disclose non-financial information whereas separate sustainability reports are targeted for stakeholders communicating more detailed and standardized information.

Generally, it is characteristic that the reporting frameworks are prepared by non-governmental organisations. The Global Reporting Initiative (GRI) is the most widely used framework for sustainability reporting.[74] However, Mähönen criticises that GRI has moved to emphasise the instrumental value of reporting by promoting business interests instead of highlighting the stakeholder accountability.[75] In any case, the GRI still standardises non-financial

[74] Mähönen 2020, p. 8.
[75] Ibid.

reporting and improves the comparability which can be seen as its strength. It is notable that all the companies in Table 1 have reported on sustainability already before the legal obligation has entered into force. In addition, the companies often have other commitments to sustainability besides the GRI, for instance to the UN Global Compact which sets out ten principles for responsible business.[76]

3 EU TAXONOMY REGULATION

3.1 Sustainable Finance from the Perspective of the Taxonomy Regulation

The European Commission published its action plan on sustainable finance in March 2018 following the final report of the High-Level Expert Group on Sustainable Finance (HLEG). One of the main objectives of the action plan was to reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth.[77] The basis of the promotion of sustainable finance within the EU can be traced back to the EU's commitments to the Sustainable Development Goals (SDGs) of the UN 2030 Agenda and to the Paris Agreement on Climate Change.[78] By promoting sustainable finance, the EU tries to ensure and enable the financing of projects that are in line with these commitments. The Taxonomy Regulation will be the backbone of sustainable finance because it supports the capital flow into sustainable activities in the need of finance by providing detailed information for market participants.[79] Therefore, the Taxonomy Regulation was seen as the most important and urgent legislative initiative of the action plan.[80]

The EU's idea to create a classification system for sustainable economic activities is not new and there are already many voluntary taxonomies, frameworks and principles. However, the EU's taxonomy is progressive because it is the first legally binding classification which reaches over the capital markets and imposes disclosure obligations.[81] The main idea behind the EU's taxonomy is to create a classification which links economic activities, investments and assets to the climate and environment-related commitments. In other words, a taxonomy

[76] See Ten Principles of the UN Global Compact.
[77] COM(2018) 97 final, p. 2.
[78] See e.g. the TR, recital 1 and 2., TEG Final Report 2020, p.8., HLEG Final Report 2018, p. 9., C(2016) 6912 final, 28.10.2016, recital 1.
[79] COM(2018) 97 final, p. 4.
[80] COM(2018) 97 final, p. 4.
[81] For instance, China has already earlier introduced taxonomies as regulatory guidance. See TEG Final Report 2020, p. 53.

identifies sustainable economic activities in order to scale up the sustainable finance and facilitate the transition into more sustainable economy.

After publishing its proposal for the Taxonomy Regulation in May 2018, the European Commission mandated the Technical Expert Group on Sustainable Finance (TEG) to develop recommendations especially regarding the economic activities contributing to environmental objectives.[82] The reports of the HLEG and TEG form an important basis for the regulation. At the same time, there has been a great political change towards more sustainable EU policies, which culminated in the announcement of the European Green Deal by the European Commission in December 2019.[83] The Green Deal underlines the need to address sustainability issues in all policy areas and approaches the complex and interlinked challenges comprehensively as a roadmap.[84]

Based on the preparatory work, the Taxonomy Regulation laying out the classification system was adopted on 18 June 2020 and the regulation entered into force on 12 July 2020. However, with regard to non-financial disclosure obligations, the provisions shall not apply until 2022 and 2023. The content of the regulation will be discussed in the next chapter.

3.2 Key Features of the Taxonomy Regulation

First of all, the Taxonomy Regulation only establishes the criteria for determining whether an economic activity qualifies as environmentally sustainable (Article 1). Therefore, the Taxonomy Regulation can be described shortly as a classification system which identifies environmentally sustainable economic activities. For the time being the social aspects and other sustainability considerations are excluded from the scope of the regulation. This resolution seems reasonable taking into account that the regulation will bring financial regulation into a new era. If the regulation succeeds in achieving its environmental objectives, the scope should be broadened into social and other sustainability considerations as well. The European Commission shall review the scope of the regulation by the end of 2021.[85]

---

[82] TEG Final Report 2020, p. 10.
[83] See COM(2019) 640 final.
[84] Ibid, p. 2-3.
[85] Also, the TR recognizes the need to address other sustainability objectives as well, especially social ones. See e.g. Article 26(2)(b).

The Taxonomy regulation classifies the economic activities into three categories: 1) environmentally sustainable activities (article 3), 2) transition activities in relation to climate change mitigation (article 10(2)) and 3) enabling activities (article 16). In a nutshell, an enabling activity does not itself substantially contribute to an environmental objective but instead, enables the other activities to contribute for instance by improving the performance.[86] The transition and enabling activities are not further discussed in this research but in general, the same principles apply to them. In practice, it must be first determined all the economic activities a company carries out. Thereafter, each economic activity must be considered vis-à-vis the taxonomy, more specifically the technical screening criteria.

Hence, the Taxonomy Regulation is built on the one hand on environmental objectives, and on the other on so-called Do No Significant Harm (DNSH) principle. The logic behind the regulation is that economic activity should substantially contribute to one or more environmental objectives and at the same time, not significantly harm any other objectives.[87] Article 3 sets out the criteria for determining the environmental sustainability of an economic activity.[88] The economic activity must be carried out in compliance with technical screening criteria. In addition to environmental objectives and the DNSH principle, the economic activity shall comply with the so-called minimum safeguards: the OECD Guidelines for Multinational Enterprises, the UN Guiding Principles on Business and Human Rights, the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work and the International Bill of Human Rights (article 18(1)). The logic for determining the environmentally sustainable economic activity is described below in Figure 2.

[86] TEG Final Report, p. 14-15.
[87] COM(2018) 353 final, p .13.
[88] Ibid, p. 13.

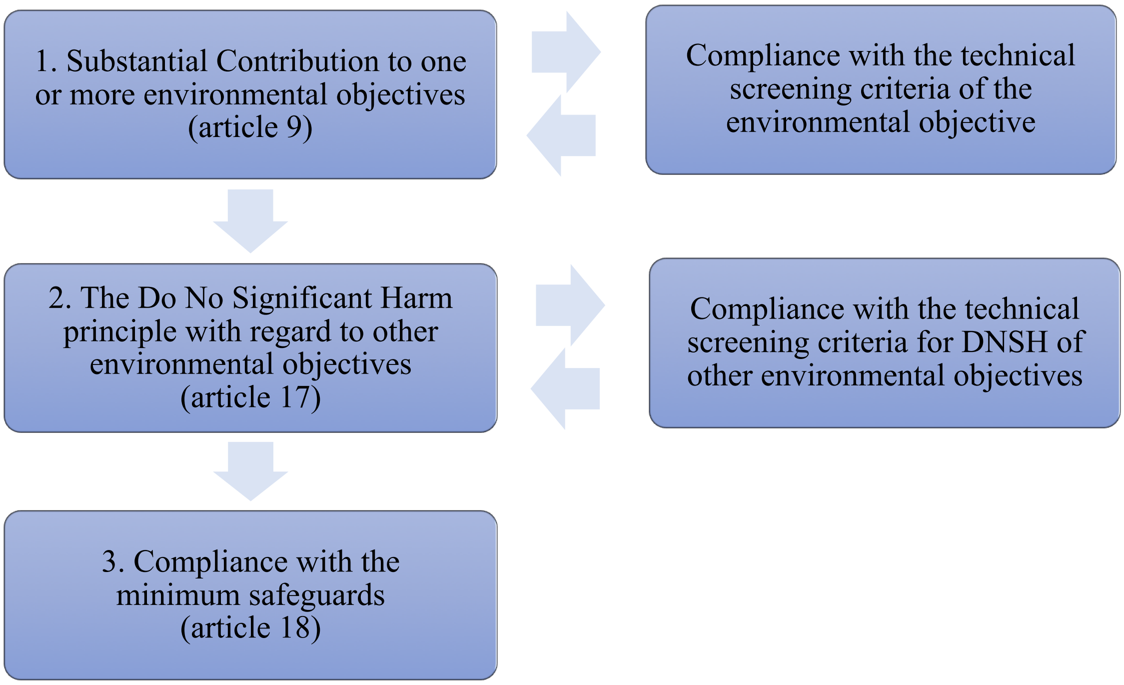

Figure 2. The logic for determination of the environmentally sustainable economic activity.

Before moving more detailed on to the logic of the classification system, a couple of notions with regard to a term "substantial contribution" to an environmental objective must be made. The classification system is built for economic activities which have potential to contribute substantially for the environmental objectives. Technical screening criteria plays a key role in this determination by specifying whether an economic activity contributes substantially or not.[89] This determination is very technical in its nature and takes characteristics of an economic activity in question into account. However, it is unclear for now which economic activities will be covered by the technical screening criteria. It seems likely that economic activities will be prioritised, e.g. based on their emissions footprint, in the drafting of the criteria.[90] Therefore, it is unlikely that the technical screening criteria will cover all the economic activities even though the EC shall review criteria regularly (article 19(5)).[91] The European Commission has not yet adopted the delegated acts which set out the technical screening criteria to determine whether an economic activity is sustainable.

[89] COM(2018) 353 final, p. 14.
[90] See e.g. TEG Final Report 2020, p.13. The TEG addresses only climate change mitigation and adaptation.
[91] The EC notes that companies are free to explain how their economic activity relates to the taxonomy, even if it is not listed in technical screening criteria, European Commission 18.12.2019. The TR also requires that the EC consults market participants on the technical screening criteria through the Platform on Sustainable Finance referred to in article 20.

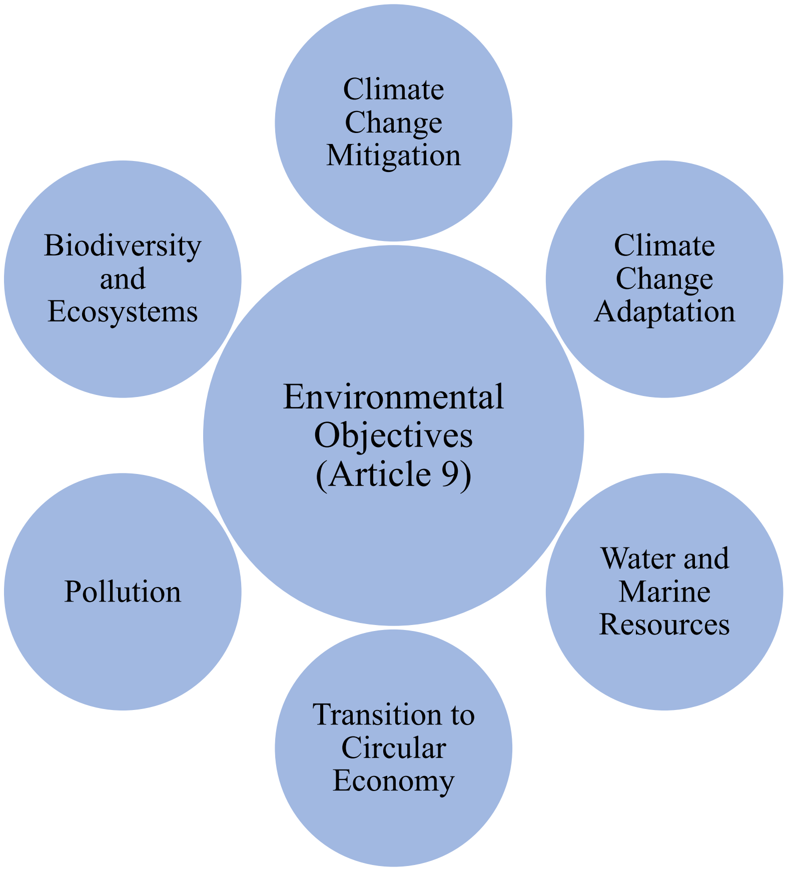

Figure 3. Environmental objectives of the Taxonomy Regulation.

The environmental objectives are defined in article 9 and presented in the Figure 3 above. The following six objectives are established: 1) climate change mitigation, 2) climate change adaptation, 3) sustainable use and protection of water and marine resources, 4) transition to a circular economy, waste prevention and recycling, 5) pollution prevention and control, 6) protection of healthy ecosystems. Articles 10-15 further define the criteria for a substantial contribution to environmental objective in question together with the technical screening criteria.

Besides the substantial contribution to an environmental objective, the economic activity shall not do significant harm for the other objectives (article 17). Similarly to the technical screening criteria already analysed, the EC will establish a separate technical screening criteria to determine whether an economic activity causes significant harm. The DNSH principle has been a sensitive topic politically especially in relation to nuclear power. However, the adopted taxonomy sets out unambiguously that the nuclear power is environmentally sustainable if it contributes substantially to an environmental objective without significantly harming the other objectives.[92]

Last but not the least, the economic activity must comply with the minimum safeguards (article 18). Through this requirement, the Taxonomy Regulation interestingly introduces social and governance criteria for a sustainable investment even though the regulation concentrates primarily on environmental perspective. This approached is welcomed due to its comprehensive approach to sustainability highlighting the companies' responsibility in the global business environment. Similarly to the DNSH principle, the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights require the companies to conduct due diligence. This is a process through which enterprises can identify, prevent, mitigate and account for how they address their actual and potential adverse human rights impacts.[93] The due diligence must be conducted on a level of economic activity.[94] It is likely that the requirements are novel at least for some companies and the TEG has also admitted in preliminary work that the assessment of the compliance and the implementation of the principles may be challenging.[95]

In summary, the core of the classification system is the technical screening criteria for each environmental objective, which are currently under preparation by the European Commission. The classifications shall be published first as delegated acts with regard to climate change mitigation and adaptation by the end of the 2020 in order to ensure the application of classification system in this respect from 1 January 2022.[96] As for the other four environmental objectives, the classification system shall be published a year later and applied from 1 January 2023.

3.3 Amendments into Disclosure of Non-Financial Information

First and foremost it has to be observed that the Taxonomy Regulation does not itself amend the obligation to disclose non-financial information. The obligation will be governed by the NFRD also in the future. However, the NFRD is currently under the European Commission's

[92] In practice, the DNSH principle may constitute an obstacle to consider nuclear power as environmentally sustainable due to disposal waste. The technical screening criteria for DNSH will later clarify the situation. See European Commission 18.12.2019.
[93] UNGPs 2011, Principle 17. OECD Guidelines 2011, p. 23 and 34.
[94] TEG Final Report 2020, p. 33.
[95] TEG Final Report 2020, p. 35.
[96] See the TR articles 10(6) and 11(6).

review as mentioned earlier, and the European Commission expects to adopt a proposal on possible revisions to the provisions of the NFRD in the first quarter of 2021.[97] Next, I am going to briefly analyse the review of the NFRD and then, discuss the new requirements enacted in the Taxonomy Regulation.

The problems of the current directive as well as objectives and impacts of the review are presented in the European Commission's inception impact assessment[98]. In a nutshell, the EC finds that publicly available information on non-financial issues is inadequate and therefore, there is no sufficient data on how non-financial issues affect companies, and in turn, what impact companies have on environment and society. Particularly the European Commission highlights that non-financial information is not sufficiently comparable, reliable, adequate and relevant.[99] The European Commission assesses the problems from investors and stakeholders perspective holding that provisions should be revised in order to provide data for informed investment decisions and hold companies accountable for their adverse impacts.[100]

The European Commission has carried out a public consultation from 20 February to 11 June 2020. One key finding is that the majority of 588 respondents, especially those who consider themselves as the users of non-financial information, agreed with the European Commission on the deficiency of comparability, reliability and relevance of the non-financial information. There are also two other interesting notions to make in the context of this research. Namely, it seems that there is a strong support for a common reporting standard and alignment of the environmental disclosure with the Taxonomy Regulation. [101]

Whereas not amending the obligation, the Taxonomy Regulation still imposes new requirements on information to be disclosed under the NFRD. Noteworthy is that the European Commission's original proposal did not include disclosure provisions but they were added on a later stage of political preliminary work. According to article 8(1), entities shall include in their non-financial statement information on how and to what extent the entity's activities are associated with economic activities that qualify as environmentally sustainable. More

[97] European Commission 29.7.2020, p. 2.
[98] European Commission 30.1.2020.
[99] Ibid, p. 2.
[100] Ibid, p. 2-3.
[101] European Commission 29.7.2020, p. 3-4.

specifically, the large PIEs must report the proportion of turnover derived from environmentally sustainable products or services as well as the proportion of capital expenditure and the proportion of their operating expenditure related to environmentally sustainable assets or processes shall be disclosed (article 8(2)).

However, the European Commission has not yet adopted the delegated acts specifying the content and presentation of the non-financial information to be disclosed. The deadline for the adoption is by 1 June 2021. Currently, it is therefore unclear, what information company should disclose if there is no technical screening criteria for its economic activity or the contribution is not included in the existing environmental objectives.[102] These new requirements shall apply from 1 January 2022 (The TR article 27(2)(a)). In other words, large PIEs must disclose non-financial information according to the Taxonomy Regulation and delegated acts first covering their financial year 2021.

3.4 Evaluation of the EU Taxonomy Regulation

3.4.1 A Step Further in Sustainability

Considering that the objective of the Taxonomy Regulation is to guide market participants in the sustainable activities, the taxonomy seems to set out relatively clear criteria. Of course, the final judgement must be made after the EC has published the first technical screening criteria. However, it must be pointed out that the taxonomy will be relatively complex to implement in companies' practices due to its technical nature. From the holistic point of view, there are two aspects to consider: 1) whether the taxonomy will reorient the capital flows to sustainable activities efficiently, and 2) whether the sustainable activities as defined in the taxonomy will be sustainable enough to tackle the climate and environment-related global challenges.

As for the first aspect, the taxonomy regulation introduces a progressive framework to define sustainable activities. However, the taxonomy is not a standard itself – it still needs to be implemented into the frameworks applied in financing decisions. One key driver for the transition to more sustainable economy is that the financial market actors and advisers must

[102] In these cases, according to the TEG, the companies should simply disclose that there is currently no technical screening criteria for the activity.

disclose sustainability risks and impacts.[103] The requirement makes it less attractive to finance or invest in activities that are not aligned with the taxonomy. Also, if the taxonomy succeeds, the market participants should be willing to apply the laid out sustainable criteria voluntarily as well instead of already existing frameworks and practices. For instance, the upcoming voluntary EU Green Bond Standard requires that the projects are aligned with the taxonomy.[104] Market indicators speak for an increasing demand for sustainable investment products. For example, the global green bond market grew 51% in 2019 reaching the overall market value of nearly 260 billion USD.[105] Therefore, hopes are high that the market participants will also voluntarily refer to the EU taxonomy in the future. This would lead to more standardized capital markets within the EU in terms of sustainability considerations.

As for the second aspect, the best available technology to carry out economic activities is constantly changing and there are no fixed actions which would guarantee that set environmental objectives are achieved. Therefore, the importance of the review mechanisms of the article 19 cannot be highlighted enough in order to keep the taxonomy up with the scientific and technological developments. With this regard, the TEG's approach to first assess the industries which have the biggest negative impact on climate seems reasonable. Consequently, the identified activities have great potential to contribute to environmental objectives through sustainable business practices.

In terms of sustainability, the new non-financial disclosure obligation on the alignment with the taxonomy is welcome and has potential to improve the quality of the current disclosure. The EC has not yet adopted a delegated act specifying the methodology to be used in defining the taxonomy alignment. Resulting from the disclosure obligation, the proportion of turnover should give a clear picture where the company is vis-à-vis the taxonomy. Furthermore, the disclosure of the taxonomy aligned proportion of the capital and operating expenditure should indicate how the company tries to improve its sustainability performance. Additionally, the TEG has recommended that these metrics are given separately for each environmental objective in order to specify which of the objectives are pursued.[106] Hence,

[103] Article 1 of the Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, OJ L 317, 9.12.2019, p. 1–16. See also recital 19 of the TR.
[104] E.g. TEG Report 2019, p. 27-28. HLEG Final Report 2018, p. 31.
[105] Climate Bonds Initiative 2020, p. 2. This is still a small fraction of total bonds outstanding worldwide. See COM(2018) 97 final, p. 5.
[106] TEG Final Report 2020, p. 28.

the purpose of the disclosure is to provide accurate and comparable information for investors and other market participants.

Last but not the least, the minimum safeguards were significantly strengthened by including the UNGPs and the OECD Guidelines in the minimum safeguards during the preliminary work.[107] One of the main concerns with the implementation of these principles has been their nature as soft law instruments.[108] It seems that companies have not implemented the principles efficiently because they have had no legally binding obligation nor sanctions due to non-compliance. Therefore, the EU's resolution can be seen as an intermediate step towards a taxonomy which covers also social considerations. It is likely that legally binding requirement to conduct due diligence with regard to companies' social impacts improve the level of implementation of the principles set out in article 18. It will be interesting to see how does the social requirements of the TR develop when the European Commission publishes a report on other sustainability objectives by the end of 2021.

3.4.2 Too Little too Late?

Even though the European Green Deal and the taxonomy introduced many improvements, it must be noted that policymakers have awakened relatively late to the environmental concerns. For instance, *Trippel* finds that the EU has only in the last two years started to view sustainability as a necessity and points out that the EU citizens could support stronger actions.[109] At the same time, the importance of the taxonomy has grown. Basically, in order to succeed in the sustainability objectives the EU should prepare for the worst-case scenario rather than rely on optimistic estimates. However, this is challenging through political consensus. For instance, some parliamentary groups supported more ambitious regulation than the EC had proposed which would have classified every economic activity on the market, according to its degree of sustainability. This would have established so-called brown list covering polluting and environmentally harmful activities in addition to the green taxonomy.[110] At the end of the day, the impacts of all policy areas must be considered together in

[107] The EC referred only to principles identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work in its original proposal, COM(2018) 353 final, p. 31.
[108] Bueno, p. 422.
[109] Trippel 2020, p. 4-5.
[110] See European Parliament 13.3.2019, p. 30 and 36. Also Trippel 2020, p. 11. The EC will review the matter again by the end of 2021.

order to reform the European economy successfully instead of only promoting sustainable finance.

When it comes to the non-financial disclosure, the obligations can be criticized due to their limitation of application to large, public-interest entities. First, it can be noted that small and middle-sized enterprises represent 99% of all businesses in the EU.[111] Second, a specific number of employees may not be a sufficient factor in order to assess company's impact on environment in today's digitalised economy.[112] Third, the comparability of the non-financial information deteriorates because the content of the reporting depends on a choice of a reporting standard or framework.

Another aspect is the reliability of the non-financial information, because there is no assurance mechanism regarding the non-financial statements. The article 19a of the NFRD requires that the statutory auditor or audit firm checks that the non-financial statement has been provided.[113] When it comes to the management report, the statutory audit or audit firm shall express an opinion, whether the management report is consistent with the financial statements prepared in accordance with the applicable legal requirements (article 34(1) of the Accounting Directive). However, the auditing covers neither the contents of the non-financial statement nor management report, which is problematic in terms of transparency and quality. Mähönen has proposed that the management report should be subject to the full audit requirements.[114] The same applies to the non-financial statement and would likely improve the quality and comparability of the non-financial reporting. In addition, this would not create an unreasonable administrative burden because the requirement would concern only the large PIEs which already have extensive audit requirements.

Finally, the governance factor of sustainability is the least addressed ESG factor in the taxonomy regulation even though the minimum safeguards cover governance considerations as well. This seems reasonable, because the EU has already earlier enacted provisions in relation to corporate governance. For instance, the Accounting Directive requires listed companies, whether they are large undertakings or not, to include a corporate governance statement

[111] European Commission 11.8.2020.
[112] Clarke & Anker-Sørensen 2019, p. 199.
[113] In Finland, the article is enacted in chapter 3a, section 6 of the Accounting Act.
[114] Mähönen 2020, p. 29.

in their management reports (article 20).[115] Corporate governance has been also a typical matter of self-regulation through national corporate governance codes and stock exchange rules. Therefore, the transparency with this regard is already on the higher level. However, a comprehensive approach to sustainability would require more attention to governance, because the current binding obligations are limited to listed companies. In my opinion, the Taxonomy Regulation should include the basic provisions on governance in the future in order to address all the ESG factors. This would benefit especially small and middle-sized enterprises by allowing them to define their sustainability based on one regulation.

4 CONCLUSIONS

4.1 Summary

This research has systemised the non-financial disclosure obligations from the perspective of sustainability. The emphasis has been on environmental sustainability which is the main objective of the European Green Deal aiming at scaling up the transition to more sustainable economy. The literature review establishes a clear relationship between the transparency, quantity and quality of the non-financial information and the economic sustainability. Therefore, the EU's Taxonomy Regulation is analysed in order to create a comprehensive overview on the recent regulatory initiatives.

The research describes the evolution of non-financial disclosure obligations within the EU in the last 20 years. One key takeaway is that non-financial reporting has moved from voluntary to mandatory with regard to large, public-interest entities. According to the article 19a of the Non-financial Reporting Directive, the large PIEs must disclose information in relation to environment, social and employee matters, human rights as well as anti-corruption and bribery. The obligations of the NFRD are enacted in the Accounting Act in Finland. However, neither the directive nor the Accounting Act imposes rules for the content of the reporting. Therefore, the companies themselves choose the reporting standard or framework to be relied upon in the disclosure. In this research, companies under scrutiny published a narrow non-financial statement in relation to the management report and a more extensive sustainability report in accordance with the GRI.

[115] In Finland, the article is enacted in chapter 7, section 7 of the Securities Markets Act (746/2012).

The Taxonomy Regulation entered into force in July 2020 creates a new unified classification system for environmentally sustainable economic activities. The Taxonomy Regulation also introduces a new disclosure requirement for large PIEs with regard to their economic activities which qualify as environmentally sustainable (article 8). More specifically, the companies are obliged to disclose the proportion of turnover as well as capital expenditure and operating expenditure aligned with the Taxonomy. However, the obligations apply on sliding scale first on 1 January 2022 concerning climate change mitigation and adaption, and on 1 January 2023 concerning the other environmental objectives.

4.2 Implications

The findings of this research indicate that the non-financial disclosure will interact strongly with the EU Taxonomy in the future. Therefore, it would be important to align the NFRD with the Taxonomy Regulation. In the future, more attention should be paid to the social dimension of sustainability. In connection with the European Commission's review on other sustainability objectives by the end of 2021, the reasonability of a stronger disclosure obligation on supply chain matters should be considered. The way I see it, the disclosure would improve the implementation of the minimum safeguards by increasing the stakeholder accountability. Also, transparency, quality and comparability should be enhanced in the future to keep up with the increasing amount of the non-financial information. This could be done by providing more detailed definition of information to be disclosed in either binding regulations or in non-binding guidelines. With this regard, lessons could be learned from the reporting frameworks and standards. This would also prevent the EU member states from adopting the national, more detailed disclosure provisions.[116]

Currently, small and middle-sized entities are exempted from the obligation in order to prevent the unreasonable administrative burden. However, the companies are often required to provide non-financial information for instance for financing purposes.[117] Therefore, a harmonized obligation to disclose non-financial information could facilitate the sustainable financing of SMEs.[118] The disclosure could be designed based on current obligation but it should be substantially lighter. For instance, SMEs should be exempted from the application of article 8 of the Taxonomy Regulation, as for now, but there could be a requirement to disclose information on environment, social and employee matters and human rights.

[116] See European Commission 29.7.2020, p. 17 and European Commission 30.1.2020, p. 3.
[117] See European Commission 29.7.2020, p. 23.
[118] The scope of application of this obligation is not discussed in more detail in this research.

The research provides clear implications that the taxonomy can scale up sustainable finance and improve sustainable business practices. However, it remains unclear if the European Green Deal initiatives will be enough to achieve the SDGs and the objectives of the Paris Agreement. In order to facilitate transition, the technical screening criteria must be regularly reviewed to promote sustainable economic activities.

4.3 Suggestions for Future Research

From regulatory perspective, it is still uncertain what amendments the review of the Non-Financial Reporting Directive will bring. In addition, the European Commission will adopt delegated act on non-financial disclosure pursuant to article 8 of the Taxonomy Regulation. Therefore, there is still a need for a legal dogmatic review in 2021 when the final provisions are adopted in order to systemise the new requirements and interpret the amendments. This would clarify the obligations and help the companies to navigate in the complex and technical system of the taxonomy.

Second, after the European Commission has adopted all the delegated acts according to the Taxonomy Regulation, there is a great need for an overview on the classification system. In addition, the Taxonomy Regulation obligates the EC to review the taxonomy regularly, first by the July 2022. Research could provide suggestions for the possible amendments with regard to the disclosure and scientifically to the environmental objectives and technical screening criteria.

Finally, based on the literature review, there is no comprehensive empirical research on non-financial reporting. The regulatory amendments could provide an interesting study design on the possible changes in the substance of reporting. A qualitative analysis would provide data whether the objectives of the regulation are achieved in terms of transparency and quality. The analysis could also provide evidence on the comparability of reporting. In the long term it would be interesting to analyse if the companies have improved their sustainability based on the disclosed non-financial information required by the taxonomy.

REFERENCES

Aarnio, Aulis: Laintulkinnan teoria: Yleisen oikeustieteen oppikirja, Helsinki: Werner Söderström Oy, 1989. (Aarnio 1989)

Armour, John., Awrey, Dan., Davies, Paul., Enriques, Luca., Gordon, Jeffrey N., Mayer, Colin., Payne, Jennifer: Principles of Financial Regulation, Oxford: Oxford University Press, 2016. (Armour & al 2016)

Beske, Felix., Haustein, Ellen., Lorson, Peter C.: ”Materiality analysis in sustainability and integrated reports”. Sustainability Accounting, Management and Policy Journal, Vol. 11, No. 1. (Beske & al 2020)

Bueno, Nicolas: “Multinational enterprises and labour rights: concepts and implementa tion” in Bellace, Janice R. & ter Haar, Beryl (eds.): Research Handbook on Labour, Business and Human Rights Law, Cheltenham: Edward Elgar Publishing, 2019, pp. 421-438. (Bueno 2019)

Carini, Cristian., Rocca, Laura., Veneziani, Monica., Teodori, Claudio: “Ex-Ante Impact Assessment of Sustainability Information—The Directive 2014/95”. Sustainability, vol. 10, No. 2. (Carini & al 2018)

Chang, Rui-Dong., Zuo, Jian., Zhao, Zhen-Yu., Zillante, George., Gan, Xiao-Long., Soebarto, Veronica: “Evolving theories of sustainability and firms: History, future directions and implications for renewable energy research”. Renewable and Sustainable Energy Reviews 2017, Vol. 72, May 2017, pp. 48–56. (Chang & al 2017)

Clarke, Blanaid & Anker-Sørensen, Linn: “The EU as a Potential Norm Creator for Sustainable Corporate Groups” in Sjåfjell, Beate & Bruner, Christopher M. (eds.): The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, Cambridge: Cambridge University Press, 2019. (Clarke & Anker-Sørensen 2019)

Climate Bonds Initiative: “2019 Green Bond Market Summary”, 5.2.2020. https://www.climatebonds.net/system/tdf/reports/2019_annual_highlights-final.pdf?file=1&type=node&id=46731&force=0. (Climate Bonds Initiative 2020)

Coffee, John C. Jr.: “Market Failure and the Economic Case for a Mandatory Disclosure System”. Virginia Law Review, vol. 70, No. 7, pp. 717-753. (Coffee 1984)

Cullen, Jay & Mähönen, Jukka: “Taming Unsustainable Finance: The Perils of Modern Risk Management” in Sjåfjell, Beate & Bruner, Christopher M. (eds.): The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, Cambridge: Cambridge University Press, 2019. (Cullen & Mähönen 2019)

Cullen, Jay., Mähönen, Jukka., Nilsen, Heidi Rapp: “Financing the transition to sustainability: SMART reform proposals”. University of Oslo Faculty of Law Legal Studies Research Paper Series, No. 2020-10. (Cullen & al 2020)

Deegan, Craig: “An overview of legitimacy theory as applied within the social and environmental accounting literature” in Bebbington, Jan., Unerman, Jeffrey.,.& O’Dwyer, Brendan: Sustainability Accounting and Accountability: Routledge, London, 2014, pp. 248-285. (Deegan 2014)

Dowling, John & Pfeffer, Jeffrey: “Organizational Legitimacy: Social Values and Organizational Behavior”. The Pacific Sociological Review, Vol. 18, No. 1, pp. 122-136. (Dowling & Pfeffer 1975)

Hirvonen, Ari: ”Mitkä metodit? Opas oikeustieteen metodologiaan.” Yleisen oikeustieteen julkaisuja 17, Helsinki, 2011. (Hirvonen 2011)

Kirjanpitolautakunta: ”KPL 3a luvun soveltamisesta PIE-yhteisön ei-taloudellisessa raportoinnissa”, 7.9.2017. (KILA 1972/7.9.2017)

Kirjanpitolautakunta: ”Yleisohje toimintakertomuksen laatimisesta”, 12.9.2006. (KILA 12.9.2006)

Leppiniemi, Jarmo & Kykkänen, Tapani: Kirjanpito, tilinpäätös ja tilinpäätöksen tulkinta, 10th edition, Helsinki: Alma Talent Oy, 2019. (Leppiniemi & Kykkänen 2019)

Mähönen, Jukka: “Comprehensive Approach to Relevant and Reliable Reporting in Europe: A Dream Impossible?” Sustainability, vol. 12, No. 13. (Mähönen 2020)

Mähönen, Jukka: ”Ei-taloudellinen informaatio ja Corporate Governance”. Defensor Legis, No. 4/2013, pp. 566-578. (Mähönen 2013)

Mähönen, Jukka: “Financing sustainable market actors in the circular economy” in Eftestöl-Wilhelmsson, Ellen., Bask, Anu., Sankari, Suvi (eds): Sustainable and Efficient Transport Incentives for Promoting a Green Transport Market, Cheltenham: Edward Elgar Publishing, 2019, pp. 95-116. (Mähönen 2019)

Organisation for Economic Co-operation and Development: “OECD Guidelines for Multinational Enterprises”, 25.5.2011. http://www.oecd.org/daf/inv/mne/48004323.pdf. (OECD Guidelines 2011)

Testarmata, Silvia., Ciaburri, Mirella., Fortuna, Fabio., Sergiacomi, Silvia: “Harmonization of Non-financial Reporting Regulation in Europe: A Study of the Transposition of the Directive 2014/95/EU” in Brunelli, Sandro & Di Carlo, Emiliano (eds.): Accountability, Ethics and Sustainability of Organisations, Cham: Springer, 2020, pp. 67-88. (Testarmata & al 2020)

The Alliance for Corporate Transparency: “Research Report 2019: An analysis of the sustainability reports of 1000 companies pursuant to the EU Non-Financial Reporting Directive”, Brussels: 17.2.2020. https://www.allianceforcorporatetransparency.org /assets/2019_Research_Report%20_Alliance_for_Corporate_Transparency-7d980 2a0c18c9f13017d686481bd2d6c6886fea6d9e9c7a5c3cfafea8a48b1c7.pdf.
(The Alliance for Corporate Transparency 2020)

The European Commission: “Commission staff working document: impact assessment Accompanying the document Proposal for a directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of non- financial and diversity information by certain large companies and groups”, 16.4.2013. (SWD(2013) 127 final)

The European Commission: “Communication from the Commission: Action Plan: Financing Sustainable Growth”, 8.3.2018. (COM(2018) 97 final)

The European Commission: “Communication from the Commission: A renewed EU strategy 2011-14 for Corporate Social Responsibility”. 25.10.2011. (COM(2011) 681 final)

The European Commission: “Communication from the Commission: Europe's moment: Repair and Prepare for the Next Generation”, 27.5.2020. (COM(2020) 456 final)

The European Commission: “Communication from the Commission — Guidelines on non-financial reporting (methodology for reporting non-financial information), OJ C 215, 5.7.2017, p. 1–20”. (European Commission 2017)

The European Commission: ”Communication from the Commission: Single Market Act — Twelve levers to boost growth and strengthen confidence — “Working together to create new growth”, 13.4.2011. (COM(2011) 206 final)

The European Commission: “Communication from the Commission: The European Green Deal”, 11.12.2019. (COM(2019) 640 final)

The European Commission: “Green paper: Promoting a European framework for Corporate Social Responsibility”, 18.7.2001. (COM(2001) 366 final)

The European Commission: “Inception Impact Assessment for the revision of the Non-Financial Reporting Directive”, 30.1.2020. (European Commission 30.1.2020)

The European Commission: “Proposal for a Regulation of the European Parliament and of the Council on statutory audit of annual accounts and consolidated accounts and amending Council Directives 78/660/EEC and 83/349/EEC”, 16.3.2004. (COM(2004) 177 final)

The European Commission: “Proposal for a directive of the European Parliament and of the Council on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings”. 25.10.2011. (COM(2011) 684 final)

The European Commission: “Proposal for a Regulation of the European Parliament and of the Council on the Establishment of a Framework to Facilitate Sustainable Investment”, 24.5.2018. (COM(2018) 353 final)

The European Commission: “Questions and Answers: political agreement on an EU-wide classification system for sustainable investments (Taxonomy)”, 18.12.2019, viewed 14.8.2020. (European Commission 18.12.2019)

The European Commission: “Summary Report of the Public Consultation on the Review of the Non-Financial Reporting Directive”, 29.7.2020. (European Commission 29.7.2020)

The European Commission: “What is an SME?”. https://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition_en, viewed 11.8.2020. (European Commission 11.8.2020)

The European Parliament: “European Parliament resolution of 6 February 2013 on Corporate Social Responsibility: promoting society’s interests and a route to sustainable and inclusive recovery (2012/2097(INI)), OJ C 24, 22.1.2016, p. 33–48. (European Parliament 2013)

The European Parliament: “Report on the proposal for a regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment (COM(2018)0353 – C8-0207/2018 – 2018/0178(COD))”, 13.3.3010. (European Parliament 13.3.2010)

The High-Level Expert Group on Sustainable Finance: “Final Report 2018”, 31.1.2018. (HLEG Final Report 2018)

The International Capital Market Association: "Seizing Opportunities in a Changing World: 2018 Sustainable Finance Outlook", November 2018. https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/Public-research-resources/EscarusSustainable-Finance-Outlook-2018-11.11.2018- 220219.pdf. (ICMA 2018)

The International Capital Market Association: "Sustainable Finance: High-level definitions". May 2020. https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/Sustainable-Finance-High-Level-Definitions-May-2020-110520v4.pdf. (ICMA 2020)

The Technical Expert Group on Sustainable Finance: "Taxonomy: Final Report", March 2020. (TEG Final Report 2020)

The Technical Expert Group on Sustainable Finance: "Report on EU Green Bond Standard", June 2019. (TEG Report 2019)

The United Nations: "The Guiding Principles on Business and Human Rights", 16.6.2011. https://www.ohchr.org/documents/publications/guidingprinciplesbusinesshr_en.pdf. (UNGPs 2011)

The united Nations: "The Ten Principles of the UN Global Compact". Viewed 14.8.2020. https://www.unglobalcompact.org/what-is-gc/mission/principles. (Ten Principles of the UN Global Compact)

The United Nations: "Transforming Our World: the 2030 Agenda for Sustainable Development". September 2015. (United Nations 2015)

Tîrcă, Diana-Mihaela., Apetri, Anișoara-Niculina., Aceleanu, Mirela Ionela: "Sustainability in Finance and Economics" in Ziolo, Magdalena & Sergi, Bruno S.: Financing Sustainable Development, Cham: Palgrave Macmillan, 2019. (Tîrcă & al 2019)

Trippel, Elia: "How green is green enough? The changing landscape of financing a sustainable European economy". ERA Forum, 7.7.2020. (Trippel 2020)

Wagner, Constance Z.: “Evolving Norms of Corporate Social Responsibility: Lessons Learned from the European Union Directive On Non-Financial Reporting”. Transactions: The Tennessee Journal of Business Law. Vol. 19, No. 2, pp. 619-708. (Wagner 2018)